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Title: Three Essays on the Economics of Shadow Banking

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Abstract: This dissertation contains three self-contained essays that investigate the economics of shadow banking. In Chapter 1, I incorporate shadow banking modeled as off-balance-sheet financing in a standard continuous-time macro-finance model. In this model, regular banks pursue regulatory arbitrage by extending businesses outside the regulatory perimeter via shadow banking. In the absence of regulatory authorities, shadow banking creates an enforcement problem, which leads to an endogenous constraint on leverage for shadow banking. Shadow banking adds to financial instability because tightening market discipline in economic downturns forces shadow banks to sell assets at fire-sale prices to regular banks. Overall, financial instability as a function of financial regulation is U-shaped rather than monotonically decreasing. This new framework can comprehensively evaluate the impact of different regulatory regimes on both the regulated and unregulated banking sectors. In Chapter 2, I modify the framework developed in Chapter 1 and modernize Minsky's "Financial Instability Hypothesis" in an economy where the financial market consists of both regular banking and shadow banking. As in Chapter 1, the friction with off-balance-sheet financing constrains the borrowing capacity of shadow banking, although shadow banking provides cheaper credit than regular banking does. Chapter 2 shows that the decline of asset volatility in economic upturns speeds up the growth of shadow banking. The overheated expansion of shadow banking exposes the economy to the risk of a self-fulfilling systemic run; in turn, this risk then may lead to the sudden collapse of the shadow banking system. In Chapter 3, I investigate two inseparable explanations for US banks' liquidity problem in the 2007-09 financial crisis: the malfunction of the securitization market and the loan commitment drawdowns. I find that US banks issue more C&I loan commitments when they perceive more loan securitization potential. A critical missing variable problem results when only one of the two is applied as an explanatory variable. I find that the exposure to C&I loan commitment takedown is the dominant influence that explains US banks' liquidity problem from July 2007 to June 2008 and that from July 2008 to June 2009 the freeze of the securitization market is the dominant influence.

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